complex cost studies and the alternative of hiring consultants is expensive.[32] Burdening small ILECs with additional costs undermines the FCC stated goal for this proceeding of making smaller ILECs better able to compete in the provision of interstate access services.

C. The FCC Has Not Made a Case for Fliminating the TIC

Another major motivation for access charge reform is the FCC's desire to eliminate or reduce the TIC. Generally, the FCC has wanted to eliminate the TIC since it can have an anti-competitive affect because the TIC must be paid even when IXCs provide their own transport.[33] However, because many rate-of-return ILECs qualify for the rural telephone company exemption provided by Congress,[34] other carriers may not be providing transport and, by definition, cannot be harmed by maintaining the TIC. If no competitor can be harmed by a rural ILEC's TIC, why must it be eliminated?

Further, Lexcom agrees with the FCC's suggestion that, perhaps, it ought to leave the TIC as is until a Joint Board reviews whether any TIC components reflect the high cost of providing transport in rural areas. As Lexcom has shown above, rural ILECs do not incur costs in the same manner as price cap ILECs, because of the lack of customer density in rural markets. Lack of customer density requires rural ILECs to deploy more capital investment and to incur higher costs than price cap ILECs to serve the same number of customers. Lexcom has not seen any data that would tend to exclude transport costs from this economic pattern. The TIC for rate-

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[32] *See* Comments of the Rural ILECs, filed in CC Docket No. 91-141 (June 8, 1998).

[33] *Access Charge Reform*, 12 FCC Rcd 15982 (1997) at ¶240

[34] 47 U.S.C. §251(f).

of-return ILECs should be left alone until the Joint Board examines the issue in detail, including its impact on universal service.

THE PROPOSED COST ALLOCATION CHANGES ARE UNSOUND

A. The Impact of the Proposed GSF Allocation Change

At present, price cap ILECs are required to use a general expense allocator to apportion the interstate portion of Accounts 2111 (Land), 2121 (Buildings), 2123 (Office equipment), and 2124 (General purpose computers) between the unregulated billing and collection category and interstate access charges. This accounting requirement ensures that IXCs are not paying overhead costs related to a deregulated billing and collection service. The FCC is now proposing to make the same adjustment for rate-of-return ILECs. The FCC notes, however, that the allocation formula used by price cap ILECs (and potentially larger rate-of-return ILECs) uses an allocator that presumes the ILEC keeps more detailed Part 32 accounts than the summary account level. Since smaller rate-of-return ILECs do not maintain such detailed accounts, the FCC requests comments on what adjustments are appropriate for the cost allocation process for small ILECs. Specifically, the FCC asks for a count of how many rate-of-return ILECs use general-purpose computers to provide billing and collection services. Also, the Commission requests comment on how these proposed changes would affect any other rate elements, as well as the impact on ILECs as small businesses.[35]

[35] *Id.* at ¶¶79-82.

Lexcom estimates that this proposed cost allocation change will shift approximately $61,000 from its traffic sensitive revenue requirement to deregulated billing and collection. While this amount of revenue requirement reduction is not major for Lexcom, it still is a significant reduction of interstate revenues in the range of $2.00 per customer, per year. The impact on some other rural ILECs may be much greater. If the FCC decides to change the allocation formula for GSF, it should phase-in this change over a three-year period to minimize the financial impact on rural ILECs.

B. Many Rural ILECs Actively Market Their Access Services

Prior to 1987, all ILEC marketing expenses were allocated between jurisdictions based upon local and toll revenues. In 1987, a Federal-State Joint Board recommended that access revenues be excluded from the allocation factor because marketing costs were not incurred in the provision of interstate access services. The FCC agreed with this recommendation and adopted new rules to that effect. On reconsideration, the FCC reversed itself, allowing access revenues to be retained in the allocator. In the *Access Reform Order*, the FCC required price cap ILECs to remove all marketing costs from interstate access charges and to recover those costs from end users, on the premise that ILECs do not market access services to IXCs. These marketing costs are now to be recovered through increases in the SLCs for non-primary residential and multi-line business customers. Any excess costs, which would put an ILEC's SLCs above the cap, are to be recovered from PICCs on non-primary residential and multi-line business customers, subject to the cap on PICCs. Further excess marketing costs are recovered first on originating common line minutes, subject to the cap, and finally on terminating carrier common line minutes. The FCC

proposes to require rate-of-return ILECs to treat their marketing expenses accordingly, and requests comments on this proposal, including appropriate changes to Part 69.

After an 11-year hiatus, the FCC is again proposing to eliminate access revenues from the allocation factor for marketing expenses based on the assumption that ILECs do not market their access services. It seems rather ironic that the FCC is proposing to disallow the allocation of any marketing costs to interstate access services in the midst of a docket that is proposing to make the access services of small ILECs more competitive. As small ILECs face competition or potential competition for access services, it seems only reasonable for those same small ILECs to incur some marketing costs associated with the provision of access services.

In addition, many small ILECs, especially those serving more rural areas, do market their access services to various business customers in competition with other ILECs. For example, a small ILECs may work with local government and business officials to develop a package that will provide an incentive for a new, high-calling-volume business, such as a call center or a telemarketing firm, to relocate to the community served by the ILEC. Other communities and ILECs may be competing against them. These marketing efforts may include direct expenditures by the ILEC or payments to a consultant. These are normal business expenses that properly can be associated with access services and should, therefore, be recognized for interstate access service ratemaking purposes.

MODIFICATION OF THE NEW SERVICES RULE

At present, rate-of-return ILECs must file and receive a Part 69 waiver to offer a new switched access service. Price cap ILECs, on the other hand, need only file a petition that shows either that another ILEC has already received approval to offer an identical rate element and did not rely upon a showing of competition, or that the new rate element is in the public interest. The FCC now proposes to allow rate-of-return ILECs to use a streamlined process and seeks comment on this proposal.

Lexcom fully supports the FCC's proposal to allow rate-of-return ILECs to use the same streamlined process used by price cap ILECs to offer new services. The simpler process has been used successfully by price cap ILECs for some time now, and there are no reasons not to extend the benefits to rate-of-return ILECs and their customers. Additionally, simplification of the process will also allow the FCC to use its own resources more efficiently.

OMISSIONS FROM THE *NOTICE*

A. Internet Traffic Has Been Ignored

The *Notice* fails to address several important access charge-related issues that affect rate-of-return ILECs. One key issue, with two sub-parts, is the impact of the Internet on rate-of-return ILECs.

Increased Internet usage has affected the costs of providing telephone service and the allocation of those costs for regulatory purposes. Increased Internet usage has increased the overall, average holding times, which, in turn, has required many ILECs to increase their switching and transport capacities. Also, since the FCC and many state regulators have treated Internet usage as intrastate traffic,[36] increased Internet usage shifts costs to the state jurisdiction. This can put upward pressure on local rates. It is unreasonable for the FCC to propose a major rewrite of the interstate access charge rules while ignoring the impact of a major change in traffic patterns and volumes.

Lexcom cannot imagine that the FCC would have rewritten access charge rules (had they existed) in the early 1960s without considering the impact of the widespread introduction of direct distance dialing ("DDD"), which made placing long distance calls simpler and cheaper. Such a change in technology and customer behavior affected both traffic patterns and volumes and would likely have been considered by the FCC in reforming access charge rules. However, for some unspecified reasons, the FCC is content to close its eyes to another major change in technology and customer behavior that is affecting both traffic volumes and patterns. Access charge reform, as proposed, must await a serious examination of Internet traffic.[37]

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[36] *See, e.g., Access Charge Reform*, 12 FCC Rcd 15982 (1997) at ¶¶345 *et seq; Brooks Fiber Communications of Michigan*, Opinion & Order, Case No. U-11178, (Mich. P.S.C., Jan. 28, 1998).

[37] Lexcom is not proposing herein that the FCC rule that all Internet traffic is *per se* interstate in jurisdiction. Internet traffic, except when used to place ordinary voice calls, is complex in nature and requires thoughtful analysis and comment. However, it is absurd and unlawful for such traffic, which can and is used to connect and communicate beyond a single state's border, to be exempt from making any contribution to the cost of the local loop. *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

Even more troublesome is the failure of the FCC to address the growth of Internet telephony.[38] Any arguments that support continued treatment of traditional Internet traffic as intrastate in jurisdiction fall by the wayside when traditional voice traffic is transmitted using the Internet protocol. Historically, long distance traffic has contributed to the support of the local telephone network irrespective of how the call was transmitted from the calling party to the called party. Switching technology has moved from cord board to step-by-step, to cross-bar, to electronic, and to digital, without exempting new types of switching technology from paying support to the local plant. Why is packet switching different? The FCC has simply ignored this question to the detriment of rural ILECs and their customers.

Similarly, long distance carriers have made major changes in their operations, from analog carrier systems on copper plant to analog microwave radio, to digital microwave radio, to digital lightwave transmission through fiber optic cable, without changing the basic rule requiring payment to support the local network. Yet, the FCC has so far refused to explain why use of the same local network to provide the same long distance voice service is exempt from payment of fees to cover the costs of the local network simply because a different protocol is used.[39] Again, it is unreasonable for the FCC to rewrite the access charge rules without addressing Internet telephony.

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[38] *E.g.*, "I-Link Goes to 4.9 Cents per Long Distance Minute," *Telecommunications Reports*, March 23, 1998, at p.35.

[39] A customer making an interstate, interexchange call over the Internet dials a standard seven-digit telephone number to be connected with the customer's serving Internet service provider ("ISP") Upon making this line-side connection with the ISP's network, the customer's personal identification code ("PIN") is entered and the ISP's network completes the call, using the Internet protocol and the ISP's network. This use of the local exchange network to make an interstate, interexchange call seems virtually identical to Feature Group A ("FGA") access service. "The standard features offered by FGA access arrangements are dial tone (originating service), dial-pulse access signaling, and lineside terminating service." Bellcore, *Notes on the Networks*, Exchange Access, (Issue 3,

B. The Costs and Benefits of Rate Regulation of Small ILECs

The *Notice* goes no further than raising a few questions about the costs and benefits of traditional regulation of small ILECs. It seems unreasonable to propose a more complex access rate structure for small ILECs unless and until the benefits and costs of such changes are addressed. Both Chairman Kennard and Commissioner Powell have recently asked the more fundamental question of should small ILECs even be rate regulated.[40] That question should be addressed before the FCC burdens small ILECs with even more complex price regulation rules, not after new rules are written.

Lexcom is not taking the position that there should be no oversight of its access service prices. IXCs and other customers have the important right to pay only just and reasonable rates. That right should be protected. However, protection of that right does not require the FCC to impose even more complex rules on small ILECs. Large IXCs, such as Sprint, MCI and AT&T, are always ready to file complaints against small ILEC's' rates when those IXCs believe access rates are unjust and unlawful. AT&T, for example, has performed statistical analysis of ILEC access charges for years to identify apparent statistical "outliers." After identifying which

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Dec. 1997) at p.15-4. Unless the FCC intends to flout the anti-discrimination provisions of Section 202 of the Communications Act (47 U.S.C. §202), those ISPs that use an ILEC's network to originate or terminate interstate voice traffic via seven-digit line-side access should pay Feature Group A access charges.

[40] *See* W. Kennard, Remarks, "Keeping America Connected," to the Organization for the Promotion and Advancement of Small Telephone Companies, Fort Lauderdale, FL, January 12, 1998; and M. Powell, Remarks, "Working Toward Independents' Day: Mid-Size Carriers as the Special Forces of Deregulation," to Independent Telephone Pioneer Association (National Chapter), Washington, D.C., May 7, 1998.

particular rates seem unreasonable, AT&T has challenged those rates before the FCC. Since AT&T is not alone in this capability, access charge reform should take this business reality into account. The FCC should make the complaint process the primary regulator of small ILEC access rates, just as it has for AT&T's long distance rates and the rates charged by CLECs, many of which operate more access lines and have larger staffs and financial resources than most small ILECs for dealing with complex rate regulation.

C. The Ability to Respond to Competition

The FCC properly recognizes that, in some circumstances, rate-of-return ILECs may be vulnerable to "cherry picking" by competitors. Many small ILECs may have a significantly large customer, such as a large manufacturing plant, a college, or a direct mail marketing firm, whose high volumes of outgoing long distance or incoming toll free calling are attractive to competition. Some of these customers may be individually responsible for as much as 25%-to-30% of the ILEC's total revenues. The small ILEC needs the flexibility to price access services to respond to competition. Yet, the FCC's *Notice* does not propose any pricing flexibility for rate-of-return ILECs. In fact, the *Notice* goes in the opposite direction by increasing regulatory and administrative costs and by loading additional costs onto originating access — which makes cherry picking easier. Lexcom submits that pricing flexibility must be an integral aspect of any access charge reform for rural ILECs.

Lexcom, through its long distance affiliate, is able to offer competitive pricing packages to large-volume customers, just as all competing IXCs can. Lower volume customers are protected by the FCC's uniform toll rates requirement and non-discrimination provisions of the FCC's rules. This same concept should be extended to interstate access charges. Lexcom and all other rural ILECs should be allowed to offer special discounted access packages to large volume customers so long as access rates for lower volume customers are not raised unfairly.

D. Universal Service

The FCC has a statutory obligation to preserve universal service in rural areas, *i.e.*, the markets generally served by rate-of-return ILECs. This obligation is essentially a requirement to ensure fairness to rural customers and residential subscribers. Fairness to end user customers of rate-of-return ILECs, as defined by Congress, requires that those customers have access to "telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."[41] Despite the FCC's confident statement[42] that rural carriers' universal service support needs have already been addressed, the FCC does not discuss the adverse impact of the kind of access charge reform that the *Notice* now proposes. The FCC should not make changes to access charges that will result in SLC increases and new PICCs passed on to end users, until the impact of those new, higher prices for service to small towns and rural areas are known and understood.

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[41] 47 U.S.C. §254(b)(3).

[42] *Notice, passim.*

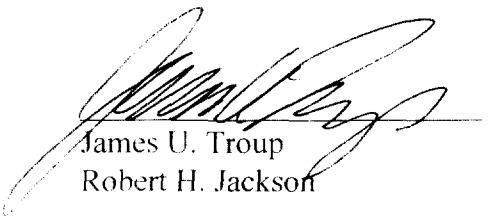
THE FCC SHOULD SUSPEND THE PROPOSED ACCESS CHARGE REFORM AND OPEN A BROAD INQUIRY INTO RATE DEREGULATION OF RURAL ILECs

Instead of proceeding with this rulemaking proceeding, the FCC should release a notice of inquiry into the rate deregulation of small ILECs, which should include, *inter alia*, the pricing of access services. The record in the current proceeding should be incorporated into the new inquiry. In addition to access charge reform, the FCC should consider (1) the type of rate regulation, if any, that is appropriate for small ILECs; (2) the impact of increased Internet traffic, including Internet telephony, on rural ILECs and their customers; (3) the level of pricing flexibility necessary and appropriate for small ILECs to avoid unfair "cherry picking" by competitors; and (4) the impact of regulatory changes on universal service. The inquiry on universal service aspects should include the further definition of what are comparable rates for comparable service between rural and urban customers.

CONCLUSION

For the reason set forth above, the FCC should not adopt the kind of access charge reform as proposed in the *Notice*. Rather, the FCC should open a broad inquiry into the overall rate deregulation of rural ILECs, as suggested by Lexcom in these comments.

Respectfully submitted,
Lexcom Telephone Company



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Appendix "A"

Methodology for Estimating Lexcom's "Outside Plant"

Lexcom does not maintain records for the number of miles of copper wires used by Lexcom to provide telephone service to customers. There are no business needs or governmental regulations requiring such records to be kept. Since Lexcom has replaced all of its interoffice copper cables with fiber optic cables, all copper wire plant is used in the local loop. Lexcom does, however, maintain mileage records for its fiber cables. Lexcom has approximately 189 miles of such cables, which are also used to provide service.

In order to estimate the number of miles of "outside plant" (fiber cables and copper wires) used by Lexcom, we have examined the route miles of both fiber cables and copper wires used by four other North Carolina local exchange carriers ("LECs") that have some similar characteristics as Lexcom. These four other carriers are borrowers from the Rural Utilities Service ("RUS") of the United States Department of Agriculture, and, as such, must report "outside plan" mileage to the RUS. These LECs (with the number of access lines)[1] are: Alltel North Carolina, Inc., Matthews, NC (137,292); Atlantic Telephone Membership Corp., Shallotte, NC (30,084); Citizens Telephone Co., Brevard, NC (14,078); and Yadkin Valley Telephone Membership Corp., Yadkinville, NC (22,348).

Lexcom calculated the number of route miles of line ("outside plant") per access line and the number of access lines per route mile of line for each LEC. An average and a median of each ratio were then calculated. The four-LEC average of route miles of "outside plant" per access line is .0902 and the four-LEC average access lines per route mile of "outside plant" is 12.12. The four-LEC median of route miles of "outside plant" per access line is .0943 and the four-LEC median access lines per route mile of "outside plant" is 10.60.

Lexcom's 32,900 access lines were divided by the average and median access lines per route mile of "outside plant" to develop a range of route miles of outside plant for Lexcom. The range is between 2,632 miles and 3,009 miles of outside plant. Lexcom believes that this estimate is reasonable.

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[1] United States Department of Agriculture, Rural Utilities Service, *1996 Statistical Report Rural Telecommunications Borrowers*, Informational Publication 300-4 (1997) at 154, 156 ("*1996 RUS Report*").

Appendix "B"

A Comparison of Investments and Expenses Required to Serve 100 Customers				
	RBOCs	Other Reporting ILECs	Lexcom (NC ILEC Average)	Lexcom (NC ILEC Median)
Customers -- Total Switched Access Lines	131,479,359	31,296,867	32,900	32,900
Miles of Outside Plant	2,730,095	1,283,342	2,632	3,009
Customers per Mile of Outside Plant	48.16	24.39	12.50	10.93
Miles of Outside Plant per Access Line	0.0208	0.0410	0.0800	0.0915
Miles of Outside Plant to Serve 100 Customers	2.0764	4.1005	8.0008	9.1458
Total Plant in Service (2001)	$ 237,913,922,000	$ 65,895,488,000	$ 73,813,086	$ 73,813,086
Total Plant-Specific Operations Expenses (650)	$ 15,689,807,000	$ 4,513,042,000	$ 3,536,241	$ 3,536,241
Total Operating Expenses (720)	$ 59,731,175,000	$ 15,755,272,000	$ 16,638,056	$ 16,638,056
Total Plant in Service per Mile of Outside Plant	$ 87,145	$ 51,347	$ 28,042	$ 24,531
Total Plant-Specific Operations Expenses per Mile of Outside Plant	$ 5,747	$ 3,517	$ 1,343	$ 1,175
Total Operating Expenses per Mile of Outside Plant	$ 21,879	$ 12,277	$ 6,321	$ 5,529
Plant in Service to Serve 100 Customers	$ 180,952	$ 210,550	$ 224,356	$ 224,356
Plant-Specific Operations Expenses to Serve 100 Customers	$ 11,933	$ 14,420	$ 10,748	$ 10,748
Total Operating Expenses to Serve 100 Customers	$ 45,430	$ 50,341	$ 50,572	$ 50,572

Sources: Common Carrier Bureau, *1997 Preliminary Statistics of Common Carriers*; Rural Utilities Service, U.S. Dept. of Agriculture, *1996 Statistical Report -- Rural Telecommunications Borrowers*; Lexcom's Part 32 accounts and other Lexcom records.

Notes: Since Lexcom does not maintain records of the number of miles of copper wires used in Lexcom's local loop plant, Lexcom calculated the average and median route miles of outside plant per access line for four comparable North Carolina ILECs to estimate Lexcom's miles of outside plant in Lexcom's local loop network. Outside plant miles for the RBOCs and the other reporting ILECs are in sheath miles, while Lexcom's outside plant are stated in route miles. Because larger ILECs tend to have multiple sheaths in a single route in dense areas, this comparison understates the investment and cost burdens of rural ILECs.

CERTIFICATE OF SERVICE

I, Stella H. Hughes, hereby certify that on July 16, 1998, a copy of the foregoing Comments of Lexcom Telephone Company, and Certificate of Service has been served on the following parties, by hand delivery.

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